

A REPORT
TO THE
ARIZONA LEGISLATURE

Accounting Services Division

Status Review

Douglas Unified School District No. 27

As of December 4, 2002



Debra K. Davenport
Auditor General

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Accounting Services Division Staff

Gregg Rickert, Manager and Contact Person
grickert@auditorgen.state.az.us

Tracy Pytlakowski
Kelly Geddis

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

June 17, 2003

Governing Board
Douglas Unified School District No. 27
P.O. Box 1237
Douglas, AZ 85608-1237

Members of the Board:

We completed a status review of deficiencies cited in the summary accompanying our June 28, 2002, letter. That summary described the deficiencies cited in the District's single audit reports and Uniform System of Financial Records (USFR) Compliance Questionnaire for the year ended June 30, 2001. The District was given 90 days to correct the cited deficiencies. The purpose of our review was to determine whether the District made the corrections necessary to comply with the USFR. Our review, which consisted primarily of inquiries and selective testing of accounting records and control procedures, was more limited in scope than would be necessary to express an opinion on the District's internal controls. Accordingly, we do not express an opinion on its internal controls or ensure disclosure of all instances of noncompliance with the USFR.

Subsequent to our status review, we received and reviewed the District's single audit reports and USFR Compliance Questionnaire for the year ended June 30, 2002.

Based on the number and nature of the deficiencies noted in our status review and our review of the 2002 single audit reports and compliance questionnaire, the District still has not complied with the USFR. Within a few days, we will issue a letter notifying the Arizona State Board of Education of the District's continued noncompliance. Recommendations to correct these deficiencies are described in this report. District management should implement these recommendations to ensure that the District fulfills its responsibility to establish and maintain internal controls that will adequately comply with the USFR. We have communicated specific details for all deficiencies to management for correction.

The District is currently under investigation by several local and federal agencies.

Thank you for the assistance and cooperation that your administrators and staff provided during our status review. My staff and I will be pleased to discuss or clarify items in this status review report.

Sincerely,

Debra K. Davenport
Auditor General

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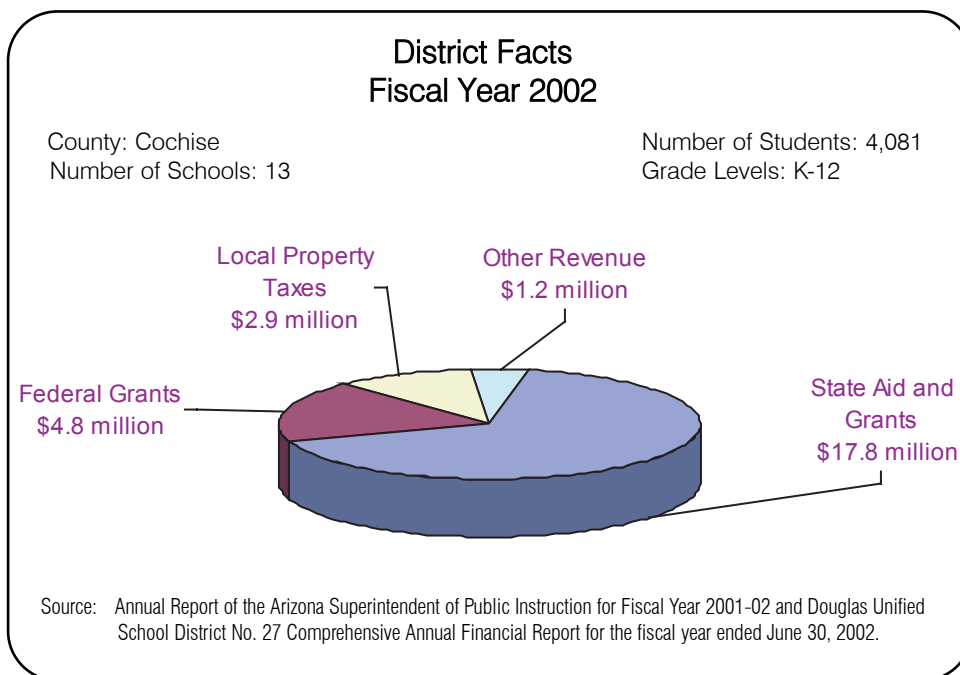
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INTRODUCTION

Douglas Unified School District No. 27 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for over \$26 million received in fiscal year 2001-02 to provide this education.

The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education (ADE). The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our status review and review of the District's single audit reports and USFR Compliance Questionnaire for the year ended June 30, 2002, we determined that the District had failed to comply with the USFR. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship, and to comply with the USFR. Our recommendations are described on the following pages.



The District should strengthen controls over its expenditures

The District spends tax dollars to purchase goods and services, so it is essential that the District follows procedures designed to help ensure that its purchases serve an educational purpose and it properly processes those transactions.

The District financed the purchase of more than 100 computers costing approximately \$195,000 for employees and a citizen. This transaction may have violated the Arizona Constitution.

The District may have violated Article IX, §7 of the Arizona Constitution, which prohibits gifts or loans of public monies by both financing the purchase of computers for employees and a citizen, and purchasing flowers. The loans or purchases would be permissible if they had an educational purpose and the benefit to the public was not greatly outweighed by the value of the loans or cost of the flower purchases. However, these issues were not considered by the Governing Board before the District granted the loans and made the flower purchases. Violations of this same constitutional provision occurred as a result of district credit cards being used to make food purchases. Specifically, from June-October 2002, several employees charged more than \$1,200 at restaurants in Douglas, Tucson, Bisbee, Willcox, and Sierra Vista. These charges would be permissible if the employees were in travel status on district business and the costs were within the prescribed per diem. However, the employees did not submit a travel reimbursement claim with accompanying receipts to justify the charges. In addition, in violation of the Constitution, the District paid \$121 for food purchased by the former superintendent on a district credit card the day after his official retirement date.

District employees used credit cards to purchase many items that should have been processed through the normal expenditure cycle. In addition, the District made other expenditures without sufficient supporting documentation. For example, consulting services provided by the former superintendent for the Special Services Department were paid from invoices that did not indicate in sufficient detail the actual work performed. Also, we noted numerous purchase orders that were prepared or approved after the goods and services were ordered or received. As a result, the District did not ensure that purchases were approved and budgeted for, or that amounts paid were proper.

Finally, the District did not comply with the State's conflict-of-interest statutes. Specifically, the District did not maintain a conflict-of-interest file for employees and board members. One board member, in violation of statute, signed three vouchers that included payments to a business owned by the board member's spouse. Additionally, the District processed purchase orders totalling \$1,317 for purchases from the same board member's spouse's business even though statutes limit purchases from board members, their spouses, or dependents to \$1,000 in a 12-month period. Further, the Governing Board had not adopted a policy allowing such purchases.

Recommendations

The following procedures can help the District strengthen controls over expenditures:

- Obtain written governing board approval for district expenditures that are not clearly for district operations. This approval should include the Governing Board's determination that such expenditures are for an educational purpose, and the costs do not greatly exceed the educational benefit provided.
- Prepare purchase orders for all expenditures, except for exempted items, before ordering goods and services. Credit card usage should be strictly limited and restricted to expenditures that require immediate payments.
- Retain documentation to support all expenditures. Ensure that invoices received include detailed information to support the actual goods or services provided.
- Ensure that a travel claim and supporting receipts support travel expenditures, and verify that reimbursements are within the Arizona Department of Administration's limits.
- Ensure that all district officers and employees who have, or whose relatives have, substantial interests in any decision of or contract with that district make that interest known in the District's records (in a conflict-of-interest file) and refrain from voting upon or participating in any manner in that decision or contract. Arizona Revised Statutes (A.R.S.) §§38-503(A) and (B), and 15-323(A)(1)
- The Governing Board must adopt a policy authorizing purchases from governing board members, their spouses, or dependents. By statute, the policy is only effective for 12 months and would have to be readopted for subsequent purchases. After that policy is approved, district purchases from a governing board member should not exceed \$300 per transaction or \$1,000 in a 12-month period. A.R.S. §15-323(B)

USFR pages VI-G-7 and 8 include suggested procedures for controlling district credit card purchases.

USFR Memorandum No. 176 includes the maximum travel reimbursement rates that the Department of Administration establishes.

The District must follow competitive purchasing requirements

School District Procurement Rules for competitive sealed bidding and USFR guidelines for purchases below the competitive sealed bid threshold promote open and fair competition among vendors. This helps ensure that districts receive the best possible value for the public monies they spend. However, the District did not follow the School District Procurement Rules or the USFR guidelines.

School District Procurement Rules list the requirements for competitive sealed bids or proposals for goods and services in excess of \$32,313.

USFR guidelines require:

- Oral quotations for purchases between \$5,000 and \$15,000.
- Written quotations for purchases between \$15,000 and \$32,313.

The District did not obtain any bids or proposals for three of five purchases tested that required competitive sealed bids or proposals, and did not complete the bidding process correctly for the other two purchases tested. The former business manager did not provide an explanation for the three purchases that were not competitively bid.

Further, one of the two purchases not correctly bid was for consulting, counseling, and psychological services that the District's former superintendent provided. A purchase requisition was prepared on July 5, 2002, for services provided from July 1-5, 2002; the former superintendent also signed the purchase requisition as the requestor, although the District no longer employed him. In addition, an invitation for bids for similar services, to begin on September 2, 2002, was published in a newspaper of general circulation on September 17 and 26. The District had no record of bids received, but paid the former superintendent over \$32,000 for these services as of April 2003, including approximately \$17,000 that was paid before the bids were even scheduled to be opened.

Also, the District issued many blanket purchase orders for \$4,999 and split purchases of athletic supplies among several vendors that, in total, exceeded \$5,000 and would have required oral price quotations, thereby intentionally avoiding the School District Procurement Rules and USFR guidelines addressing competitive purchasing.

Contract auditors noted additional violations of School District Procurement Rules and the USFR guidelines during the June 30, 2002, audit. Some of the violations include not awarding contracts to the lowest bidder, not documenting the reasons for awarding contracts to vendors that submitted bids or proposals, and not obtaining three written or oral price quotations. The District even awarded one contract to a vendor that stated it was unable to submit a bid.

Recommendations

To strengthen controls over competitive purchasing, the District should establish and follow the policies and procedures listed below:

- Obtain competitive sealed bids or proposals for construction, materials, or services exceeding \$32,313.
- Include all required information in the invitation for bids, including bid evaluation factors.
- Issue the invitation for bids at least 14 days before the time and date set for bid opening, unless the District determines a shorter time is necessary.

- Open bids in the presence of one or more witnesses, and document the name of each bidder, the bid amount, and any other relevant information.
- For competitive sealed bids, award the contract to the lowest responsive bidder whose bid conforms with the criteria set forth in the invitation for bids. The District should retain documentation showing the basis for determining the successful bidder in its official records.
- For competitive sealed proposals, document in writing the proposal determined to be the most advantageous to the District based on the factors set forth in the request for proposals. The District should award the contract to that vendor and maintain supporting documentation for the basis of the award.
- Obtain written price quotations from at least three vendors for purchases costing between \$15,000 and \$32,313, and oral price quotations from at least three vendors for purchases costing between \$5,000 and \$15,000. If the District cannot obtain at least three quotations, it should document the vendors contacted and their reasons for not providing a quotation.
- Assign an employee, who is not responsible for preparing the purchase requisition, to approve each purchase by signing and dating the purchase requisition.
- Prepare purchase orders for all expenditures, except for exempted items, before ordering goods and services.

The District should maintain accurate capital assets and stewardship lists

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. Effective stewardship requires the District to have an accurate list of these assets. However, the District had not updated its capital assets list for all items acquired, disposed of, or transferred, or performed a complete physical inventory, in the last 3 years. As a result, the District could not reconcile capital expenditures to items added to the capital assets list or the current year's capital assets list to the prior year's list to help ensure that the list had been accurately adjusted for items acquired and disposed of.

Further, the District's capital assets list showed 439 computers received from the School Facilities Board as one item, had inaccurate descriptions for some items, and had inaccurate or nonspecific locations for many other items. Weak controls over capital assets prevented the District from providing evidence that the 439 computers received from the School Facilities Board were on the District's premises. Finally, the

The District could not provide evidence that 439 computers received from the School Facilities Board were on the District's premises.

The stewardship list should include the item's description, identification/tag number, location, and month and year of acquisition.

The capital assets list should include the information described on USFR pages VI-E-2 and 3.

Instructions for performing a physical inventory are listed on USFR pages VI-E-8 and 9.

District lacked documentation to support the cost of some assets on the list and did not tag or otherwise mark all equipment items with an identifying number.

Recommendations

The following procedures can help the District improve control over its capital assets and ensure that its stewardship and capital assets lists are accurate and complete:

- Maintain a stewardship list of capital asset items costing \$1,000 or more but less than \$5,000 (or the District's capitalization threshold approved by the Governing Board if less than \$5,000).
- Maintain a capital assets list of items costing \$5,000 or more and with useful lives of 1 year or more.
- Affix a tag with an identifying number to each equipment item costing \$1,000 or more, or specifically identify the asset on the lists by some other means such as serial number.
- Perform a physical inventory of all capital assets owned by the District at least every 3 years. Assign an employee who has no custodial responsibilities to reconcile the physical inventory to the existing lists and make all necessary corrections.
- Retain all documentation supporting items added to or removed from the lists. If the District cannot locate documentation to support the actual costs of assets, it may use an estimated historical cost obtained from appraisals, bond issue documents, or governing board meeting minutes.
- Update the lists annually for items acquired, disposed of, or transferred.
- Reconcile items added to the capital assets list during the fiscal year to capital expenditures for that year and make all necessary corrections.
- Add items acquired during the current year and subtract items disposed of during the current year to reconcile the prior year's list to the current year's list. Make all necessary corrections.

The District should improve controls over bank accounts

Because of the relatively high risk associated with transactions involving cash, school districts should establish and maintain effective internal controls to safeguard cash.

Consequently, district management should take steps to ensure that bank accounts are adequately insured, bank account reconciliations are accurately prepared, bank accounts are used for their intended purposes, and that signature stamps are properly controlled.

However, the District did not accomplish these objectives. For example, the District did not have collateral for its Bank One and Bank of America accounts in excess of \$100,000, the Federal Deposit Insurance Corporation (FDIC) threshold. As a result, deposits of \$238,697 in these two accounts were uninsured and uncollateralized at June 30, 2002. Additionally, at fiscal year-end, the District had unreconciled differences totalling \$25,168 between its records and the banks' records. Further, the District's high school and elementary/middle schools' student activities clubs' balances did not agree with its reconciled bank account balances by as much as \$1,948.

The District did not always follow statutes with respect to its use of bank accounts. Specifically, the District violated A.R.S. §15-1101 by issuing a salary advance from the Maintenance and Operation (M&O) Fund revolving account. Also, district staff used one signature stamp with two authorized signatures to sign Auxiliary Operations Fund checks, in violation of A.R.S. §15-1126.

Recommendations

To help strengthen controls over bank accounts and help ensure accurate recordkeeping, the District should perform the following:

- Obtain a collateral agreement for each bank account for balances on deposit in excess of the FDIC threshold.
- Assign an employee not responsible for handling cash or issuing checks to prepare written bank reconciliations monthly for all bank accounts, and investigate and correct all differences immediately. If one employee must perform both functions, another district official should review and approve the reconciliations.
- Restrict bank account use to legally authorized purposes only. For the M&O Fund revolving bank account, the only disbursements authorized by statute are for immediate cash outlays which includes postage, freight, express, fuel taxes, parcel post, travel, and other minor disbursements. Disbursements for salaries are prohibited.
- Ensure that all Auxiliary Operations Fund checks are signed by two independent district employees authorized by the Governing Board. If signature stamps are used, there should be only one signature per stamp; and access to each stamp should be restricted to only the authorized check signer.

The District should comply with rules for reporting student attendance

The State of Arizona provides funding to school districts based on membership days and absences. Membership days are counted from a student's entry date to the withdrawal date. Therefore, the District should accurately document student entry and withdrawal dates to help ensure that it receives its fair share of state aid. However, the District did not always accurately record entry and withdrawal dates for high school students and ensure that the dates were supported.

Recommendations

To help ensure that membership and absence days are accurately reported, the District should perform the following:

- Prepare an enrollment form for each student entering the District and a withdrawal form for each student leaving the District. Ensure that an appropriate district administrator signs the forms, verifying the accuracy of the entry and withdrawal dates.
- Have a second district official review the enrollment and withdrawal forms to ensure that the entry and withdrawal dates agree with the District's attendance records.

The District should ensure the accuracy of its accounting records

The District's Governing Board depends on accurate information so it can fulfill its oversight responsibility. The District should also report accurate information to the public and agencies from which it receives funding. To achieve this objective, management should ensure that transaction amounts are recorded correctly, in the appropriate accounts, and in the proper fiscal year. However, the District did not fully accomplish this objective. Specifically, the District recorded and paid expenditures and recorded tuition revenue in the wrong fiscal year. In addition, for all five adjusting journal entries tested by the contract auditors, a district employee did not approve the entries before they were posted to the accounting records

Recommendations

The following procedures can help the District record and report accurate financial information:

- Record expenditures in the fiscal year in which the goods or services were received.
- Record revenues in the fiscal year earned if received within 60 days after fiscal year-end.
- District management should review and approve all journal entries before they are recorded in the accounting records. Evidence of such approval should be documented.

The District should ensure tax credit monies are used for the intended purpose

A.R.S. §43-1089.01 allows taxpayers to receive tax credits up to \$250 for contributions and extracurricular activities fees paid to districts. However, the contract auditors noted that the District inappropriately allowed donors of extracurricular tax credit monies to designate student activities clubs and the District's parent organization as recipients of the monies.

Extracurricular activities tax credit monies were inappropriately designated for use by student activities clubs and the parent organization. These monies should be returned to the Extracurricular Activities Fees Tax Credit Fund.

Recommendation

The District should maintain detailed records to document that monies contributed by taxpayers are used for extracurricular activities. Since these monies belong to the District, student activities clubs and parent organizations are not legal recipients and the taxpayers' tax credits may be in jeopardy. Therefore, the District should return all of these designated contributions to the Extracurricular Activities Fees Tax Credit Fund.